HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. # Ranking Democratic Member

214 O'Neill HOB # Washington, DC 20515 # 202-226-7200 #www.house.gov/budget_democrats

July 19, 2001

Dear Democratic Colleague:

Last week, the Bush Administration conceded that the budget surplus for the ongoing fiscal year, 2001, will be about $40 billion lower than they had hitherto maintained. This means that, after the previous Administration finally ended the misguided practice, the federal government will once again tap the Medicare Trust Fund surplus to finance day-to-day operations.

Ever since the release of its preliminary budget *Blueprint* last February, the White House has argued that the Medicare Trust Fund surplus does not exist. Indeed, Bush Administration officials have even tried to minimize the importance of the Social Security Trust Fund. Now that it has become clear that the Bush tax cut, and the Bush tax cut alone, has already tapped the Trust Fund surpluses, Democrats must be prepared to respond to these specious arguments. The enclosed House Budget Committee Democratic staff analysis explains the flaws in these arguments.

If you have any questions about this analysis, please contact me or the Democratic staff of the House Budget Committee at 226-7200.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member

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Fuzzy Budget Math and the Facts

Last week, the Bush Administration conceded that the budget surplus for the ongoing fiscal year, 2001, will be about $40 billion lower than they had hitherto maintained. This means that, after the previous Administration finally ended the misguided practice, the federal government will once again tap the Medicare Trust Fund surplus to finance day-to-day operations.

Ever since the release of its preliminary budget *Blueprint* last February, the White House has tried to argue that the Medicare Trust Fund surplus does not exist. Indeed, Bush Administration officials have even tried to minimize the importance of the Social Security Trust Fund. Now that it has become clear that the Bush tax cut, and the Bush tax cut alone, has already tapped the Trust Fund surpluses, Democrats must be prepared for these bogus arguments to come back to the fore.

Following is an account of the fuzzy thinking put forward by the Bush Administration, and its flaws:

Fuzzy thinking: Democrats use the wrong measure of the surplus. We should not include the Medicare Part A surplus. Medicare is much worse off than anyone understands. Medicare Part A and Part B should be combined, and if they are, there is a deficit.

The Bush position is that Medicare has no surplus, so we should spend it. This makes no sense. The separation of Medicare Part A from Part B is the law. The Medicare Part A surplus is the law. The two parts of Medicare were designed to be separate, in part to provide important budget disciplines that would be lost if they were combined. Furthermore, given that Medicare faces financial pressure with the coming retirement of the baby boom, saving the Medicare surplus is the **least** we should do to prepare for the future.

The Bush Administration has parted company with Republicans in the Congress on this issue. House Republicans voted unanimously to put the Medicare surplus in a lockbox — before the White House told them, and us, that there is no surplus. We agree with most Congressional Republicans, and with America's seniors, that there is a Medicare surplus, and that it must be protected.

Fuzzy thinking: We still have the Social Security surplus, even if we dip into Medicare's surplus. So there will be a very large surplus anyway.

If the Social Security surplus is considered immense, it is because the fiscal challenges of the aging population are more than immense. In fact, because Social Security's surplus is projected to run out and become a deficit — because Social Security's surplus is not enough to maintain the program in the long run — saving the Social Security surplus is the **least** that we must do now to protect the security of our elderly. In fact, we need to save **even more** than the Social Security surplus to keep the benefits for the elderly safe for the long run. And because the problems faced by Medicare are analogous to those of Social Security, driven by population aging — and by additional cost increases in medical care besides — we must do at least the same for Medicare.

Beyond that is the issue of prudence. Despite all of the recent bad news, the Administration still seems to think that, in the end, all budget forecasts come true — or if they don't, it is because surpluses prove to be even larger than projected. The Republicans should remember the enormous projection errors of the overly optimistic budget forecasts of the 1980s, after the last imprudent tax cut. The baby-boom generation begins to retire under Social Security in just seven years; and economic and budget forecasts are notoriously uncertain. It would be a mistake of historic proportions to assume that running projected budget surpluses right down to zero, right up to the retirement of the baby boom, is responsible policy. Even if the numbers prove true, this tax cut was a risk not worth taking; a margin of safety would have vastly reduced the risks that the American people must now run.

Finally, even if the Administration's numbers prove true, the tax cut has eliminated the greatest prospect for Social Security reform before the baby-boom generation retires. Every plan to buttress Social Security, from left, right, or center, has required substantial additional resources to fund the so-called "transition costs." The surplus gave us the opportunity to achieve such an advance in good time, before the bulk of the baby boom was on the doorstep of retirement.

But now, even under the Administration's own estimates, the surplus beyond Social Security and Medicare is trivial until 2008, when the first baby boomers can claim Social Security benefits. This best opportunity is therefore lost. The Administration's preferred approach, using Social Security's own surplus to fund Social Security reform, is like pulling yourself up by your own bootstraps. Taking funds out of Social Security now simply and directly worsens Social Security's existing problem. The same is true of Medicare, except that its problems are, if anything, more urgent.

Fuzzy thinking: But the Social Security and Medicare surpluses are just accountants' games. They have no real economic significance. The money in the Trust Funds is just paper IOUs that mean nothing. Spending the Trust Fund surpluses would be no big deal. And arguing for protecting those surpluses is just fear-mongering.

Nothing could be more wrong. If the federal government protects a Social Security or Medicare surplus, it adds to the nation's savings. That facilitates business investment, which strengthens the economy — which makes the budget and the economy better able to support a growing retired population.

The Trust Fund's assets are U.S. Treasury securities, which are known around the world as the safest investment there is. The United States has never defaulted on a debt, in the Trust Funds or elsewhere, and no one should suggest that we would. If the government were to default on its Trust Fund securities, it would cast doubt on the safety of every Treasury security in the market. If and when the time comes when the Treasury must redeem the securities in the Trust Fund, it will have to sell Treasury bills, notes and bonds to the public to raise the cash.

It will be essential at that time that Treasury securities be trusted by investors, domestic and foreign; denigrating the Trust Fund's Treasury securities now will make that process more expensive for the taxpayer. It will also be essential that we have a strong economy, so that there will be willing and able buyers for those new Treasury securities. Protecting the Social Security and Medicare surpluses now will increase national saving, increase private investment, and build an economy that is more able to buy those securities.

Finally, the very fact that Social Security and Medicare surpluses are temporary, and are likely to erode with the retirement of the baby boom, suggests strongly that we should not build them into the nation's ongoing budget plans. Once the baby boom retires, and the budget forces begin to reverse, the necessary adjustments will only be harder if there are long-term plans already geared to using those surpluses for tax cuts.

Fuzzy thinking: But what difference does it make if we run a surplus? All we do with it is give the money to rich bondholders — who, incidentally, have nothing to do with providing Social Security or Medicare benefits. Besides, we already have enough surplus to pay off the entire available debt within ten years.

We have to pay our bondholders in any event, even if we don't run a surplus. This Bush Administration argument suggests that we have the option of not protecting the Medicare surplus, and then not paying bondholders. But the United States has never defaulted on a debt, and repaying bondholders is an obligation secured with the full faith and credit of the federal government.

We do have one choice: We can pay the bonds off now, or we can pay them off later — plus interest. Every American household knows that you are better off paying off your debts than paying interest. Furthermore, if we pay off the debt now, we will have less interest to pay when the baby boom does retire and begins to collect Social Security and Medicare benefits. So we would be wise to be fiscally responsible now.

And we should not be so complacent as to assume, a decade ahead of time, that projected surpluses will certainly materialize and the debt will certainly vanish. The imminence and the fiscal risk of the retirement of the baby boom make such over-confidence dangerous. Instead, we should be paying off our debt as quickly as possible, building budgetary strength to withstand the pressures that the aging population will bring. Dissipating the surplus now just makes paying off our debts that much more difficult — and with the retirement of the baby-boom generation at hand, we are in no condition to take risks. If we remain prudent, and prepare now for the future costs of population aging, there will be plenty of time to enjoy any fruits of continued budget strength. But the Bush tax cut runs the risk of worsening the budget, and requiring painful adjustments just as the baby boom's retirement makes budgeting most difficult.